No. 14,549

In the

United States Court of Appeals

For the Ninth Circuit

Spencer Grant, Executor of the Last Will and Testament of Blanche Kelleher Grant, Deceased,
Plaintiff-Appellant and Appellee,

vs.

James G. Smyth, former Collector of Internal Revenue,
Defendant-Appellee and Appellant.

Closing Brief for Plaintiff-Appellant and Appellee Spencer Grant

Appeals from the United States District Court for the Northern District of California, Southern Division

Edgar T. Zook
Henry V. Colby
McKeon & Colby
310 Sansome Street
San Francisco 4, California
Attorneys for Plaintiff-Appellant and Appellee

PARKER PRINTING COMPANY, 150 FIRST STREET, SAN FRANCISCO 5

INDEX

TABLE OF AUTHORITIES

Cases

Statutes, Regulations and Rulings

No. 14,549

In the

United States Court of Appeals

For the Ninth Circuit

Spencer Grant, Executor of the Last Will and Testament of Blanche Kelleher Grant, Deceased,
Plaintiff-Appellant and Appellee,

vs.

James G. Smyth, former Collector of Internal Revenue,
Defendant-Appellee and Appellant.

Closing Brief for Plaintiff-Appellant and Appellee Spencer Grant

Appeals from the United States District Court for the Northern District of California, Southern Division

---

INTRODUCTION

Plaintiff (executor) filed an opening brief in his cross-appeal. Defendant (ex-Collector) thereafter filed a consolidated brief in both cross-appeals in which he replied to

plaintiff's opening brief (Def. Brief 9-16, 27-28) and argued his own cross-appeal (Def. Brief 16-27). Therefore, this present brief is also filed in consolidated form.

INTER VIVOS CHARACTER OF TRANSFER

Mrs. Grant's purchase of the annuity contracts in 1938 and 1939 resulted in completed lifetime or *inter vivos* transfers in those years. It is elementary that no testamentary transfer is involved in this case—that no transfer of any kind occurred at her death. Plaintiff as survivor simply began to enjoy for the first time the benefits of the prior transfers. The property transferred (contingent survivorship contract rights) had irrevocably passed to him at the time of purchase of the annuity contracts. This is why 1939 Code 811 (c), which deals only with *inter vivos* transfers, controls. Defendant concedes this.

However, throughout his brief, including his "Questions Presented," "Statement of Points," "Summary of Argument" and continuously thereafter, he seeks to escape from the consequences derived from the fact that only a lifetime transfer is involved. He does so by reiterated reference to "the annuity contracts *acquired by the husband at the decedent's death*," "the annuity contracts *which were transferred upon the death of the decedent*," "the annuities *which passed to the decedent's husband at her death*." This is nothing but artificial coloring and only emphasizes how unpalatable defendant finds the *inter vivos* nature of the transfer for his purposes. Of course, if we were dealing with a transfer testamentary in character, there might be merit in defendant's contention that single life contracts are comparable for valuation purposes. But we are not—and defendant's persistent cloud-seeding efforts cannot wash that fact away.

STATUTES AND REGULATIONS INVOLVED

A. Bearing on "excludability" issue:

Section 811,
1939 Internal Revenue Code

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property * * *

(c) (As amended by Sec. 7(a) of Technical Changes Act of 1949—63 Stat. 891) *Transfers in Contemplation of, or Taking Effect at, Death.*

(1) *General Rule.* To the extent of any interest therein of which the decedent has at any time made a transfer * * * by trust or otherwise

(A) in contemplation of his death * * *; or

(B) under which he has retained for his life * * * the possession or enjoyment of, or the right to the income from, the property * * *; or

(C) intended to take effect in possession or enjoyment at or after his death.

(2) *Transfers taking Effect at Death—Transfers Prior to October 8, 1949.*—An interest in property of which the decedent made a transfer on or before October 7, 1949, intended to take effect in possession or enjoyment at or after his death shall not be included in his gross estate under paragraph (1) (C) of this sub-section unless the decedent has retained a reversionary interest in the property * * *.

Technical Changes Act of 1949
(63 Stat. 891)

SEC. 7. TRANSFERS TAKING EFFECT AT DEATH.

*   *   *   *   *   *   *   *

(b) The amendment (of Sec. 811(c) I. R. C.) made by subsection (a) shall be applicable with respect to estates of decedents dying after February 10, 1939. The provisions of Section 811(c) of the Internal Revenue Code, as amended by Subsection (a), shall * * * apply to transfers made on, before, or after February 26, 1926 * * *.

B. Bearing on "valuation" issues:

Section 22(b),
1939 Internal Revenue Code

SEC. 22. * * * (b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

*   *   *   *   *   *   *   *

(2) *Annuities, etc.*

(A) *In General.*—* * * Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income * * * equals the aggregate premiums or consideration paid for such annuity * * *.

Treasury Regulations 105.

SEC. 81.10. VALUATION OF PROPERTY.—(a) General.—* * * All relevant facts and elements of value as of the applicable valuation date should be considered in every case.

*   *   *   *   *   *   *   *

(i) *Annuities, life, remainder and reversionary interests.*—

*   *   *   *   *   *   *   *

(2) The value of an annuity contract issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts.

(3) All other future payments are to be discounted upon the basis of compound interest at the rate of 4 per cent a year. If the time of payment or of payments is dependent upon the continuation of, or upon the termination of a life or of lives, the Actuaries or Combined Experience Table of Mortality, as extended, and established actuarial principles are to be used in the computation of the present worth. For the purpose of the computation the age of a person is to be taken as the age of that person at his nearest birthday.

ARGUMENT

I. The Annuity Contracts Were Excludable from Mrs. Grant's Gross Estate Under the Technical Changes Act of 1949.

This proposition was developed in the opening brief in plaintiff's cross-appeal (Pf. Br. 7-25). Defendant's answer distills into two parts: (1) The *Clise* decision by this Court controls in holding that the purchaser of a joint and survivor annuity contract retains a life interest in "the property transferred" to the survivor-annuitant and (2) the contrary decisions cited by us (Pf. Br. 16-23) are not in point.

Our opening brief speaks for itself with respect to the *Clise* case in which this Court was not advised by counsel there of the many contrary decisions. We ask only that one of the two alternative grounds for decision there be held inapplicable here.

The contrary decisions cited by us are not distinguishable. *Hirsh v. United States*, 35 F.2d 982 (Ct. Cl. 1925) is apposite. The case did involve the question whether there was a retained life interest transfer (p. 985):

> "The sole question remaining in the case is whether after this transfer to his children (in exchange for a single life and survivorship annuity contract) the decedent retained any interest in the securities so transferred * * *."

The court concluded that he did not.

In *Commissioner v. Twogood's Estate,* 194 F.2d 627 (C.A. 2-1952), the court said (p. 629):

> "* * * no life interest was retained by the decedent * * *, in no sense can it be said that the payments the decedent received (in his lifetime) were derived from any retained interest in what his then wife might receive (if she survived) * * *."

In *Estate of Bergan v. Commissioner,* 1 T.C. 543 (1943), a single life annuity contract was involved. The Commissioner argued that the annuitant retained a life interest because in effect the annuity payments were for the support of the annuitant, but the Tax Court held that no interest was retained. Defendant says this case is not in point because "in the case of a single life annuitant *nothing in the annuitant's estate passes* to another." This is only more artificial coloring unwarranted by the record. The elemental fact is that *nothing "passed" or was transferred to plaintiff on Mrs. Grant's death, either.* The transfer to him was *inter vivos* and took place years before her death. The *Bergan* and several of the other cases cited by us squarely hold that the purchaser of a single life annuity *for her own benefit* retains no life interest. Then, how in reason can it consistently be said that the purchaser of a survivorship annuity *for the benefit of another* (whether or not coupled with a single life or joint life annuity) does retain a life interest?

Defendant says that the cases holding that an insurance company issuing an annuity contract is not a trustee are not in point because he does not urge that the insurance companies here were trustees. We cited those cases because they cannot be reconciled with the alternative basis for decision in *Clise*, to wit, the view there expressed that in effect Mrs. Clise had created a trust fund and reserved a life interest "with the remainder over."

We respectfully submit that the numerous decisions cited by us—which are only a representative selection—and of which this Court was not advised at all by counsel in the *Clise* case—cannot be rationalized with the alternative basis for decision in that case.

II. The Annuity Contracts Had a Value of $60,980 Which Was the Date of Death Cost of Comparable or Survivorship Contracts.

This proposition was developed in the opening brief in plaintiff's cross-appeal (Pf. Brief 25-39). Defendant's answer (Df. Br. 27-28) is confined to the sole point that survivorship contracts are not comparable because on the day of Mrs. Grant's death the insurance companies would not have sold survivorship contracts to her.

Here, we wish to remark parenthetically that medical examinations are not required of purchasers of annuity contracts; however, if an insurance company knows that the purchaser has an incurable disease likely to prove fatal before he lives out his life expectancy, it will refuse to issue a contract because it would be unfair to the purchaser-annuitant in the case of a single life contract and unfair to the company in the case of a survivorship contract. See *Denbigh v. Commissioner*, 7 T.C. 387, 388 (1946).

Now, as we said in plaintiff's opening brief (p. 36-37), the fact that Mrs. Grant could not have purchased survivorship

contracts on the date of her death is completely beside the point. The "comparable contract" regulation says that value "is established through the sale by (the same) company of comparable contracts." It does not say that the sale must be to the decedent or even that the company must have been willing to sell to the decedent up to the moment of death. The test plainly intended—and the only rational one—is what would the cost have been to *any* qualified purchaser. The record establishes that on March 2, 1947, the aggregate cost of survivorship contracts to *any* qualified purchaser was $60,980 (R. 125-141).

It was shown in plaintiff's opening brief that single life contracts are an entirely different kind of thing from survivorship contracts, that only survivorship contracts are comparable to the Grant survivorship provisions from an actuarial or cost standpoint, and that the taxpayer was sustained in both cases in which the issue was raised (*Higgs* case, 12 T.C. 280, and *Twogood* case, 15 T.C. 989). In our view, defendant has made no defense at all on this issue, and we find it significant that the Commissioner did not appeal in either *Higgs* or *Twogood*.

We do not comprehend in the least defendant's closing sentence (Df. Br. 28) that it is unnecessary for this Court to pass on this issue "because the (plaintiff) is barred by limitations from recovering more than the amount of the deficiency paid on September 22, 1950." It was stipulated at the trial (R. 62-63) that if plaintiff should prevail on this survivorship contract valuation issue, he should have judgment for an overpayment of $29,397.68, this being the full amount of the deficiency payment. Thus, it is decidedly necessary for this Court to pass on this issue even though recovery of any greater amount is barred by limitations.

III. Single Life Contracts Are Not Comparable from an Economic Benefit Standpoint Because of Their Much More Favorable Income Tax Treatment.

Coming now to defendant's cross-appeal, we have no quarrel with the underlying philosophy of the "comparable contract" valuation regulation. However, the date of death single life contracts relied on by defendant are not comparable to the Grant contracts for two reasons. *First,* single life contracts are not comparable from an actuarial or cost standpoint — but survivorship contracts are — as demonstrated in the preceding subdivision of this brief; *second,* single life contracts are not comparable from an economic benefit standpoint and, because of much more generous income tax treatment, have much greater value than the Grant contracts.

A. THE DATE OF DEATH SINGLE LIFE CONTRACTS ENJOY A MUCH MORE FAVORABLE INCOME TAX STATUS THAN THE GRANT CONTRACTS.

This readily appears from the income tax consequences of Section 22(b)(2)(A) of the 1939 Internal Revenue Code (see page 4 of this brief). Ever since the Revenue Act of 1934 and until the Revenue Code of 1954, the holder of an annuity contract has been required to include in taxable income each year an amount equal to 3% of the *original consideration* paid for the contract.*

When we apply this 3% income tax rule to the Grant contracts, we find that of the $20,774 paid to plaintiff each year he has had to return and pay tax on $11,700 (3% of the original cost of $390,000); this leaves him only *$9,074 as tax-free return of capital each year.* However, when we

*The 1951 amendment of Section 22(b)(2) of the 1939 Code substituted the estate tax valuation for the original consideration for purposes of this 3% rule but this amendment was applicable only in the case of post-1950 estates.

apply the 3% income tax rule to the single life contracts relied on by defendant we find that of the same $20,774 payable under those contracts each year the purchaser would return and pay tax on only $7,713 (3% of the 1947 date of death cost of $257,117). This would leave the holder of the date of death single life contracts with *$13,061 as tax-free return of capital each year* or virtually $4,000 more in tax-free return of capital per year than plaintiff receives under the Grant contracts.

This is far more significant when we note that plaintiff would have to live to the very ripe age of 96 to recover tax-free the capital value of $257,117 placed on the Grant contracts by defendant, whereas a holder of the date of death single life contracts costing exactly the same amount would fully recover his capital investment tax-free at the age of 86 under the 3% rule. The consequence of this difference is further magnified in light of the fact that plaintiff's life expectancy was only 9.96 years on March 2, 1947 (R. 35), which would take him only to the age of 76 years in any case. In other words, it would take almost 50% again as long for plaintiff to get back the capital value placed by defendant on the Grant contracts as it would under the date of death single life contracts.

The $4,000 per year greater tax-free return of capital under the single life contracts is a substantial and differentiating factor. It is one of the relevant facts and elements of value to be considered consistently with the Commissioner's own regulation to that effect (Reg. 105, Sec. 81.10(a)):

> "All relevant facts and elements of value as of the applicable valuation date should be considered in every case."

The full weight of this tax factor appears when it is realized that during plaintiff's almost 10 year life expectancy, the single life contracts would return about $40,000 more tax-free capital than the Grant contracts under the 3% rule and that this would increase to $75,000 at age 86 and to *$115,000 at age 96.*

Is it possible that defendant doubts that the value of a tax-free dollar is greater than the value of a taxable dollar? After income tax exemptions, deductions and credits, a tax-free dollar is currently worth at least 20% more than a taxable dollar. This is reflected in the relatively greater market value of tax-exempt municipal bonds as contrasted with otherwise comparable corporate bonds. The net effect of the 3% rule in this case is to give annuities paid under the date of death single life contracts an annual $4,000 tax exemption which the Grant annuities do not have.

Defendant's claim that single life contracts are comparable to the Grant contracts ignores this difference in income tax treatment of the annuity payments. However, because of this difference, it cannot be said that the single life contracts are comparable for valuation purposes. No one in his right mind, not even a tax collector, would pay $257,000 for an annuity contract which would give him a tax-free return of capital of only $9,000 per year (as under the Grant contracts) if he could pay precisely the same amount for an otherwise identical contract except that it would give him a tax-free return of $13,000 per year (as under the date of death single life contracts). Defendant's valuation basis completely disregards this vital difference in economic results and cannot be sustained under the authorities.

In valuing annuity contracts as well as other property interests, *all* relevant and material facts must be considered

and none may be singled out or disregarded. For example, in *Denbigh v. Commissioner,* 7 T.C. 387 (1946), the Tax Court rejected the Commissioner's argument that in valuing the Denbigh annuity contracts no weight should be given to medical testimony that the surviving annuitant would not live more than one or two years where she had a 12 year life expectancy under standard mortality tables. The Court said that

> "Such tables are only evidentiary and they need not be controlling.
>
> *   *   *   *   *   *   *
>
> "The question is, What was the value of these particular contracts on July 12, 1943? Sec. 811, Internal Revenue Code. All facts material thereto may, indeed must, be considered."

More specifically as applied to our case, it has been held that *all of the economic benefits* of an annuity contract must be considered in valuing it for tax purposes. See *Commissioner v. Edwards,* 135 F.2d 574 (C.A. 7-1943), which affirmed 46 B.T.A. 814. This case involved gift tax and the question for decision was what value should be placed on the annuity contracts which comprised the gifts. They were not joint and survivorship contracts but were single life contracts which included provisions for guaranteed refund and cash surrender privileges. The donor had purchased the contracts in 1934 and donated them in 1936. The Commissioner argued that the value of the contracts for gift tax purposes was what it would have cost on the date of the gift to have purchased "comparable" contracts from the same company. However, the evidence showed that the insurance company which had issued the contracts had changed the basis for computing the cost of such contracts. As a result of the changed cost basis, the guaranteed refund and cash sur-

render benefits were relatively more valuable under the 1936 contracts to the extent of about $43,000 and $27,000 respectively. On this showing, the court held that the cost of the 1936 contracts was not a fair measure of the value of the donated 1934 contracts and said (p. 576):

> " 'All of the economic benefits of a policy must be taken into consideration in determining its value for gift-tax purposes. To single out one and to disregard the others is in effect to substitute a different property interest for the one which was the subject of the gift.' Guggenheim v. Rasquin, 312 U.S. 254, 257, 61 S.Ct. 507, 509, 85 L.Ed. 813. Inasmuch as it appears from the evidence that various substantial rights and economic benefits were included in the policies suggested by the commissioner for comparison, which were not embraced in the contracts transferred, we think the court rightfully concluded that the factors of the allegedly 'procurable contracts differentiate them unmistakably from the contracts under consideration.' The value could not be established by consideration of comparable contracts for the simple reason that no comparable contract was procurable."

Certainly, there can be no question—and defendant does not deny—that under the 3% income tax rule the economic benefits under the Grant annuity contracts are substantially less than under the date of death single life contracts. We have seen that a purchaser of the 1947 single life contracts would enjoy the equivalent of an annual $4,000 tax exemption to which plaintiff is not entitled under the Grant contracts. Obviously, anyone would be willing to pay more for the single life contracts than for the Grant contracts on an open market. This means that the single life contracts, being more valuable, are not comparable so that their cost does not establish the March 2, 1947 value of the

Grant survivorship contracts and the Court below correctly so concluded (R. 45).

The 1954 Revenue Act abolished the 3% income tax rule and substituted a much more fair basis for taxing annuity payments (1954 Code 72). This change, in recognition of the harsh effect of the former 3% rule (which generally operated to prevent the annuitant from fully recovering even his purchase price during his life expectancy), does away with the difference in income tax treatment present in the instant case. However, the 1954 Code change has no bearing on the 1947 value of the Grant contracts for two reasons. In the first place, the date of death single life contracts relied on by defendant were entitled to the equivalent of an aggregate $28,000 tax exemption benefit not given to plaintiff during the seven years between Mrs. Grant's death and the adoption of the 1954 Code; in the second place, value at death must be determined in the light of circumstances then existing.

Defendant's Contentions Are Untenable.

Defendant suggests two closely related reasons for disregarding the substantial difference in income tax benefits in determining comparability for valuation purposes (Df. Br. p. 25-26). Both are patently specious.

Defendant's first point is that "there is no *necessary* relationship" between income tax treatment and estate tax treatment of annuities and, if there were, it might as well be argued that the Grant contracts should be valued at $390,000 "because they are valued at that figure for income tax purposes." In the first place, they are *not* valued at that figure for income tax purposes. That figure is the 1938-1939 *cost basis* figure and is not a "valuation" figure in the remotest sense. It would not even be a relevant factor in determining value eight years later in 1947.

In the second place, while there may be no *necessary* relationship between income tax law and estate tax law as a general rule, nevertheless tax consequences or other statutory burdens are always relevant factors in valuation cases. The impact of a tax statute as an element of value in a particular case cannot be dismissed and we have already mentioned the commonplace example of tax-exempt municipal bonds. For another example, the value of an article of jewelry for gift tax purposes includes not only the price but also the federal excise tax paid by the donor. Thus, in a very recent Revenue Ruling (Rev. Ruling 55-71, I.R.B. 1955-7, p. 8), taxpayers are advised by the Treasury that in determining fair market value for estate and gift tax purposes,

> "* * * all relevant facts and elements of value as of the applicable valuation date should be considered.
>
> * * * * * * *
>
> "The existence of the Federal excise tax on jewelry, furs, and other related articles of personal property sold by dealers, is an item which will tend to increase the amount at which an individual or an estate would be willing to sell such property. It is an element which affects the general market for that type of property.
>
> "In view of the foregoing, it is held that *the Federal excise tax* on jewelry, furs, and related articles of personal property *is a relevant factor* which should be considered in determining the fair market value of such property *for Federal estate and gift tax purposes.*" (Our emphasis)

Evidently, the Treasury is quite able to find a necessary relationship between different tax statutes when it suits the Treasury's own valuation purpose.

For an analogous example, the market value of requisitioned property cannot exceed the statutory ceiling price,

as held in *United States v. Commodities Trading Corp.*, 339 U.S. 121 (1950).

In *Old South Association v. City of Boston*, 99 N.E. 235 (Mass. 1912), the court held that the tax-exempt status of land owned by a charitable organization was an element of value to be considered in measuring the city's liability in a condemnation case.

Defendant's second and final point made in trying to escape the force of the 3% income tax rule is that neither the 1951 amendment of the 3% rule nor the recent 1954 Code provision (Sec. 72) abolishing the 3% rule and substituting a fairer income tax treatment for annuities "even purport to determine what value is to be included in the gross estate." We find it difficult to dignify this with any reply. Suffice it that there is no reason why they should; they deal with different matters on the surface. But this does not mean that the consequences of such dealing are to be ignored. Defendant is here simply putting in another guise the "not in *pari materia*" contention he made below which the recent Revenue Ruling and other valuation authorities cited above show to be only a phantom.

Defendant admits—as he must—the fact of the greater income tax burden on the Grant annuities. Hence, he cannot conscientiously deny that single life contracts are more valuable. No sane purchaser offered a choice of either the Grant contracts or the single life contracts for $257,000 or any other amount would ever choose the Grant contracts. Defendant's sole defense, to wit, his suggestions that there is no "necessary" relationship between estate and income tax statutes and that the income tax statute does not "purport" to define value for estate tax purposes, is tantamount to a plea of *nolo contendere*.

B. BECAUSE OF SUBSTANTIALLY DIFFERENT INCOME TAX TREATMENT, IT APPEARS THAT NO DATE OF DEATH CONTRACTS OF ANY KIND WERE COMPARABLE TO THE GRANT CONTRACTS.

Defendant argued below that if difference in income tax treatment is to be taken into account, then not only are date of death single life contracts more valuable than the Grant contracts but date of death survivorship contracts are even more valuable (because, with a cost of only $60,980, only $1,820 would be taxable each year under the 3% rule in the case of survivorship contracts instead of $7,710 in the case of the single life contracts and $11,700 in the case of the Grant contracts). Defendant said that because date of death contracts offered for comparison with a decedent's contracts always would have a better income tax status under the 3% rule, this would create "a hopeless dilemma" because there never could be a comparable date of death contract in any case. Before conceding the apparent truth of this and showing that the lower Court found the correct valuation solution, we wish to digress.

In the first place, this is the first occasion on which the 3% income tax point has been presented to any court in any annuity contract valuation case. We base this assertion on our examination of every reported federal valuation decision involving annuity contracts and of the briefs in most of the cases and on correspondence with attorneys for the taxpayers. We find that in every instance the point was overlooked and we are calling the matter to this Court's attention, as we did below, so that the Court will be informed that it is a case of first impression. Being a case of first impression, the *Mearkle* and other decisions cited by defendant on pages 18-19 of his brief are no precedent. Defendant quotes from *Mearkle*, including the court's observation that "There is no evidence in the record" indicating that the use of single life contracts produced arbitrary results (Df. Br.

19). The decision is no precedent whatever because the court there and in the other cited cases was not shown that the different income tax treatment under the 3% rule does operate to produce an arbitrary and unreasonable result. The point was simply overlooked by both court and counsel.

In the second place, we do not maintain that the comparable contract basis of valuing annuities is controlling here but only that, if it is—not in theory but in operative fact—then only survivorship contracts are comparable from an actuarial or cost standpoint and single life contracts are not. However, in the course of developing the income tax point, we became aware that it excluded not only single life contracts as a basis for comparison but also excluded survivorship contracts. It finally became and remains our own carefully considered conviction that the income tax point is thoroughly sound and in truth does impeach the use of any type of date of death contract for comparative purposes in the case of pre-1951 estates. This is because the cost of either survivorship or single life contracts on date of death would aways be lower than original cost of the decedent's contracts (due to reduction of the surviving annuitant's life expectancy) so that *any* date of death contract invariably would have an inherent built-in tax advantage under the 3% income tax rule.

In the third place, the 1951 amendment of 1939 Code 22 (b)(2) and the enactment of Section 72 of the 1954 Code operate to eliminate the difference in income tax consequences in the case of all decedents dying after 1950 so that plaintiff's "3% rule" contention can have no significant effect on the revenues.

Finally, there is no absolute sanctity in any Treasury regulation and when a particular valuation regulation produces an arbitrary and unreasonable result, as the commis-

sioner's misuse of the comparable contract basis does in this case, it will receive judicial condemnation:

Maass v. Higgins, 312 U.S. 443 (1941);
Helvering v. Safe Deposit & Trust Co., 95 F. 2d 806 (CA4-1938);
Commissioner v. Shattuck, 97 F. 2d 790 (CA7-1938).

With this digression, we turn now to the solution of the apparent dilemma created by the lack of any comparable date of death contracts.

C. THE COURT BELOW CORRECTLY DETERMINED THE VALUE OF THE GRANT CONTRACTS TO BE $160,399.

Section 81.10(i)(3) of Regulations 105 as applicable in 1947 (set out on page 5 of this brief) provides in effect that, in the absence of comparable contracts, the value of a decedent's contracts is to be determined on a discounted present worth basis, using a 4% interest rate and the survivor's life expectancy obtained from the Actuaries or Combined Experience Table of Mortality (known as the "Table A" valuation basis). This is the basis, consistently, which plaintiff used to compute the returned value shown in the estate tax return as filed (R. 28-29). This is the valuation basis used by the Court below after it concluded that no comparable date of death contracts were available (R. 47).

There is nothing at all unique in this solution. The Commissioner regularly uses this Table A formula to value every annuity contract (including annuity contracts issued by charitable organizations, business corporations and individuals) except one issued by an insurance company. For example, if one of the Grant contracts had been purchased from Harvard University—or Pomona College—the Commissioner would have accepted the returned value for it.

Obviously, an annuity dollar is the same whether paid by Harvard University or Annuity Insurance Company. It makes no real sense to value a contract issued by the former at $160,399 and an identical contract issued by the latter at $257,117 as the Commissioner has done here. So there is not any "impropriety" in applying the Commissioner's own actuarial or Table A valuation basis to the Grant contracts in the absence of any comparable date of death contracts. There should also be some salve for defendant in the fact that under the 3% rule plaintiff, despite the expectancy on March 2, 1947 that he would live to be only 76 (R. 35), actually would have to live to be 85 before full capital recovery of even the $160,399 valuation amount!

Defendant is critical because the record does not show plaintiff's life expectancy under "any of the annuity tables" but only shows an expectancy of 9.96 years under the Combined Experience Table of Mortality (Df. Br. 23). A "mortality table" is an actuarial basis for ascertaining the probable number of years a person of a given age and of ordinary health will live: *Butler v. Butler,* 230 N.W. 575, 579 (Minn. 1930). Defendant's criticism seems misplaced inasmuch as he not only *stipulated* to plaintiff's life expectancy under the Combined Experience Table (R. 35) but this table also is the very table prescribed by the Commissioner for determining life expectancy in computing the value of all annuity contracts where no "comparable" contracts are obtainable, as well as the value of all life estates and remainders (Reg. 105, Sec. 81.10(i)(3).

D. THE VALUATION OF $160,399 WAS NOT BASED ON SINGLE LIFE CONTRACTS.

Defendant flatly asserts that in using the Table A actuarial valuation basis prescribed by Regulations 105 (Sec. 81.10(i)(3)), the lower court "sanctioned a valuation based

upon single life annuities" (Df. Br. 21-24). We respectfully suggest that the argument as apparently made is in derogation of the record, smacks of the superficial and borders on the frivolous.

The sole "premise" for this flat assertion is found on page 21 of his brief where defendant, without explanation or reason, simply posits that

> "the actuarial certificate attached to the estate tax return * * * purports to value *single life annuity contracts* at $160,399.45 (R. 103-104) and is the basis of the value found by the Court (R. 47)."

This is without any foundation constructed by defendant or which can be discovered by logical analysis.

The truth is that the value of $160,399 determined by the lower Court and also by the actuaries in their certificate was the value based on application of the discounted present worth formula prescribed in the Treasury Regulations for use when no comparable contracts are obtainable. The actuarial certificate itself is captioned (R. 28) "Valuation of joint and survivor annuities under Table A of Regulations 105," coupled with use of the age, interest and mortality table factors specified in the Regulations. Also, the lower Court's findings and conclusions recite (R. 39, 47):

> "If there are no comparable contracts, it is stipulated that they should be valued on an actuarial valuation which is stipulated to be $160,399.00, and plaintiff should recover $28,603.43. (This is the valuation used in the estate tax return.)
>
> * * * * * * *
>
> "The Court concludes therefore that the true value of the annuity contracts as of the date of Mrs. Grant's death is represented by the Actuaries or Combined Experience Table of Mortality and established actuarial principles as set out in Treasury Regulation 105,

Section 81.10(a)(i)(3). * * * This value has been stipulated to be $160,399.45. * * *."

In his own Statement of Facts in his brief filed with the lower Court, defendant stated:

> "The annuity contracts were included in the estate tax return (filed) by plaintiff at a total of $160,399.45, being the commuted value of the annuities payable to plaintiff using a 4% interest rate and Mr. Grant's then life expectancy of 9.96 years under the Combined Experience Table of Mortality."

There is not one iota of support in the record for any notion that the $160,399 valuation is "based on single life annuities."

However, having leaped somehow to this fallacious premise, defendant then proceeds to urge that the Table A formula set out in the Regulations uses different factors than insurance companies use in computing replacement costs of single life contracts and gives a lower value than such replacement costs; that because the Table A formula valuation is "based on single life annuities, it necessarily follows that the annuities in question were comparable to single life annuities." If we understand this twist (and, frankly, we are not sure), it would apply to any annuity contract being valued under the Table A formula with the positively weird result that in any case where there were no comparable date of death contracts, value should always be determined not under Table A, after all, but by replacement cost of single life contracts even though they are not comparable.

To approach it from another side in a sincere effort to perceive whether defendant's depiction is more than still life, it seems to us that defendant is trying to use a syllogism which goes about as follows:

(1) Having found that no comparable contracts were obtainable, the lower Court followed the prescribed alternative or Table A valuation basis and valued annual payments to plaintiff for life in accordance with such basis.

(2) A single life annuity contract calls for annual payments for life.

(3) Therefore, the Court "based its valuation on single life contracts" so that "it necessarily follows that the annuities in question were comparable to single life annuities" so that single life replacement cost should have been used instead even though single life contracts are not comparable.

The most we can say of this, if it supplies the steps with which defendant has not favored us, is that it sounds like the horrible example in any course in basic logic: A cow has four legs; a horse has four legs; therefore, a cow is a horse.

This brings us back to the track we were on: No date of death contracts are comparable from an economic benefit standpoint under the 3% income tax rule; therefore, the lower Court correctly valued the Grant contracts at $160,399 in accordance with the discounted present worth basis prescribed in the Regulations for all annuity contracts when comparable ones are not obtainable.

CONCLUSION

First, the Grant contracts were excludable from gross estate under the Technical Changes Act of 1949 because Mrs. Grant retained no life interest in the contingent survivorship contract rights transferred to plaintiff at the time of purchase.

Second, single life contracts take no account of the survivorship feature of the Grant contracts and therefore constitute a different kind of property from an actuarial or cost standpoint; if the comparable contract basis is applicable in this case, only survivorship contracts are comparable.

Third, the much more generous income tax treatment of date of death contracts under the 3% rule forces the conclusion that date of death single life contracts are not comparable for this further reason; if, as we would agree and as the lower Court concluded, this differentiating factor also is present in the case of date of death survivorship contracts, no date of death contracts are comparable; it follows that the Grant contracts were correctly returned at their discounted value of $160,399 which is the value found by the Court below.

Respectfully submitted,

Edgar T. Zook
Henry V. Colby
McKeon & Colby

Attorneys for
Plaintiff-Appellant and
Appellee